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Investing in China: Opportunity and Barriers in a Complex Chinese Economy

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Investing in China

Opportunity and Barriers for Foreign Investors in a Complex Chinese Economy

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Executive Summary

Introduction:

China's economy has exploded since the introduction of free market policies which brought the populous nation to the world stage. China now boasts the second largest economy in the world and will overtake the United States in the near future. The easing of restrictions on foreign direct investment (FDI) allows foreign businesses to enter the marketplace easier than in the past, which is making the switch to China easier for businesses. Obstacles are still prevalent in the communist controlled country, which can cause trouble for businesses not properly prepared for the move into the Chinese economy. However, there are numerous major advantages companies are weighing in deciding whether or not to expand their business to Asia's largest economy.

Barriers to Consider:

China is still in the transition to a market economy, but there are still signs of the old state-controlled economy found throughout the economic landscape. Restrictions on FDI are still present in particular industries, which causes investing in these areas to be more difficult or even impossible. State-run industries are considered off-limits for foreign companies either through strict regulations or through government support of state owned companies. Companies must also consider the Anti-Monopoly Law which also is deterring larger foreign businesses from entering China. The law has been heavily criticized for targeted foreign firms while protecting domestic companies. Furthermore, the government regulations and officials often put pressure on foreign companies and many times participate in corrupt practices. Many of the barriers can be avoided though careful research and planning done well in advance.

Advantages and Disadvantages:

China has placed itself in a spot which encourages continued growth while providing a multitude of benefits to foreign firms. Consumerism has grown considerably over the past years, and many foreign firms are looking to capitalize on the rapidly growing disposable income found in the urban population. In addition, the industrial infrastructure inside the country has expanded to accommodate a variety of industries. Industrial parks and Economic Development Zones (EDZ) host a variety of benefits, which foreign firms should closely consider when investing. While China has become substantially more business friendly, disadvantages still occur in multiple areas and must be considered. IPR violations and government ownership problems frequently occur with businesses operating within China. These continue to plague companies while the government struggles to mitigate the problems.

Future Outlook and Recommendations:

While China continues to transition to a market economy, the future is still uncertain with many factors possibly impeding growth in the sector. Political dealings largely stand to hamper economic progress in the region. To mitigate the potential pitfalls of starting a business in China, there are multiple steps that can be done proactively. Through careful research and planning, deciding to open a business in China can secure massive profits in a rapidly expanding market.

Contents

1. Introduction.....	1
2. Economic Transition.....	2
2.1 Communist Revolution	2
2.2 Rebuilding through Xiaoping.....	4
2.3 Old Versus New.....	5
2.4 Strict Regulations	6
3. Barriers to Entry.....	7
3.1 Restrictions on Foreign Direct Investment	7
3.2 Anti-Monopoly Law.....	9
3.3 Regulations and Bureaucracy.....	12
3.4 Corruption.....	15
4. Advantages of Operating in China.....	18
4.1 Rise of Consumerism.....	18
4.2 Access to Massive Industrial Parks and the Labor Force	22
4.3 Special Economic Zones (SEZs) and other Free Trade Areas	24
4.4 Momentum of the economy.....	27
4.5 Transition to a Market Economy.....	29
5. Disadvantages for Businesses in China	31
5.1 Ownership Restrictions.....	31
5.2 Intellectual Property Rights Violations	35
6. China’s Economic Future	37
7. Recommendations.....	40
8. Conclusion	44
Exhibits.....	46
Works Cited.....	47

1. Introduction

With lucrative business deals in the billions of dollars, many companies have their eyes set on investing in the world's fastest growing major economy. For years China has experienced unprecedented growth in their economy, and many times gaining growth in the double digits. There are many reasons why companies are moving overseas, and China boasts a combination of factors that make investment there very attractive to foreigners. With a blend of cheap labor, lenient environmental regulations, growing middle class, immense industrial parks, and a rapidly growing economy, China seems like the perfect place to establish, move, or expand a growing business while gaining a competitive edge over rival businesses. Unknowing to many potential investors, there is also a multitude of barriers to enter the Chinese market stemming from the complicated business environment which the Chinese economy operates under. Navigating and understanding the restricting and confusing business environment requires taking an in depth look into why and how the economy operates the way it does. Companies must be aware of the close relationship and control the government holds over the economy and the many businesses that inhabit it. Looking past all of these barriers, there are still a multitude of reasons to invest in China. Businesses must weigh the various advantages and disadvantages before deciding the long process of starting a business in China, which is aided by knowledge of the complexities found throughout the business structure in China. In order for companies to make an informed decision on whether to invest in China or not, the businesses need to grasp the intricacies of the Chinese business climate and properly weigh the arguments for and against starting or expanding their business in the world's second largest economy.

2. Economic Transition

2.1 Communist Revolution

To understand what the current business climate and economic policies are, one must look at the strict communist beginnings where many current ideals formed. For much of China's history from the eighteenth century to the mid-twentieth century, the country steadily became influenced by imperialism from European countries and then from Japan. China was known as a very secretive and solitary country, shying away from outsiders until trade opened them up to the West. While being plagued with local conflict for much of its history, China was geographically isolated from other countries outside the immediate region. When China was opened to the West, countries were quick to exploit the population, government, and resources. The most recognizable illustration of this imperialism and manipulation happened when the British introduced opium to the population of China, and then completely humiliated the Chinese military and government with the Treaty of Nanking. This lopsided treaty created further mistrust of outsiders, and the effects could still be seen when the United Kingdom finally returned Hong Kong to China in the 1990's.

Fast forward to the early twentieth century and the Communist Party of China (CPC) and the foreign backed Chinese Nationalist Party (KMT) were involved with an extensive and bloody civil war which lasted for almost half a century. One of the main reasons for the CPC's support against the ruling government of China was the weak position of China on the world stage, and the foreign domination that the country experienced for centuries (Gabriel). The Communist Party wanted to free itself from foreign influences and raise China to a world power as it once was. While becoming more independent, the party also eradicated the old feudal lords and relationship that still made up the countryside, and introduced a government mixed economy by redistributed the wealth to the rural poor. After initially granting more economic freedoms to the

rural farmers, the government slowly started controlling the economic landscape by confiscating the freedoms that were previously granted. The process that occurred from 1949 to approximately 1957 was the transition to a command economy which is laid out in communist theory. Ironically, this system created farming collectivism, which basically reinstated the feudal relationships (“The Chinese Economy from 1949”). The people were not in control of their goods, with the government instead put in charge of how to best organize and distribute the goods. This system turned out to be a failure when production took a sharp decrease and productivity plummeted. There was no self-motivation for the workers who had just previously been working for themselves and personal gain. The food was collected by the government and redistributed, giving no incentives for the everyday worker. Leader of the party and country, Mao Zedong, saw the failure resulting in the new economic structure, which prompted the public dissent in the Hundred Flowers Movement.

The same issue appeared again during The Great Leap Forward, where natural causes mixed with the low output of collectivism in farming and other areas caused widespread famine and economic chaos (Exhibit 2). In addition to the already staggering number of deaths that have been estimated upwards of 45 million people, China’s national income decreased by 54% and the value of industrial output declined by 94% (Su). The previous attempts at an ideologically communist approach to the economy was simply not working, and instead plunged the country to new lows. While China did keep strong with its goal of being independent from major foreign powers that were looking to exploit its resources, the economy and businesses were crashing at the result of strict government ownership (“The Great Leap Forward”). The distrust in outsiders was still strong as strength from within the country was heavily emphasized from the Communist Party to the people. Clearly, a change was needed to rebound the injured economy, causing the

introduction of more pragmatic modifications which countered the previous ideological approach.

2.2 Rebuilding through Xiaoping

One of the modernists who was now put in charge of raising the country out of the rubble of the economic turmoil was Deng Xiaoping. The French and Russian educated chairman took over power after Mao's death in 1976, and was tasked with bringing China into a new modern age. Deng planned to do this by using a new approach to business and economy. Xiaoping initiated the Four Modernizations, which would propel China back into the world economy after its clasp during the Great Leap Forward (Watkins). Agriculture, science, industry, and national defense were all to be modernized, which seemed to go against the flow of communist thought. Modernization was deemed to be associated with the West, which Mao would have never allowed during his rule.

The business and economic implications of the Four Modernizations and other economic progress would truly revolutionize the country in terms of the economy and business development. He saw the failed system of collectivism and how the output declined sharply since the program took hold, which prompted him to slowly give the freedom back to the farmers to control their own crops. This handing over of power back to the individual was controlled at first, but once word got around that they had a choice, the whole agriculture society took power back as output soared. Xiaoping knew that China itself could not modernize the major industries in the country with their limited budget and resources. For the first time in decades, China opened its doors once again to foreign investors to help grow the various industries in China with the most notable being the steel industry. The output goals for the industry suffered as a result of the past state-run system, and were not going to meet the new expectations set in the Four

Modernizations. This led to Xiaoping to look for outside help, illustrating the need to become part of the global economy. German and Japanese steel companies were paid billions of dollars to build new steel complexes in the country in order to update the industry and increase output. In addition, to finance all of the new projects, China looked to European banks to finance their massive projects because the practice of selling the communally gathered agriculture goods was no longer enough to fund the country's business advancements. This solved many problems which were prevalent in the business sector in China, and Xiaoping went as far as allowing towns and villages to engage in agreements with companies from British controlled Hong Kong (Watkins). This provided certain towns and areas the capital and the business know-how to grow the business and make an efficient company. China still feared the impact of outside sources on its highly self-contained society, which prompted the rule of any foreign investments from Hong Kong or other permitted sources of capital could take a maximum of 49% ownership. This way foreign ownership of any company was impossible, and foreign influence could never grow too large. This slow transition away from strict Communism helped China prosper into a new age that Xiaoping envisioned when he took power.

2.3 Old Versus New

Through examining the recent history of the Chinese economy and the formation of private and state businesses, much can be revealed about the current climate in China. The Communist Party ruled in strict accordance to Marxist ideals, and while Xiaoping and the modernists deviated with free market ideas, the social and political system were still very strong and alive. China is still based with communist ideals, and is still technically communist being ruled by the Communist Party of China which is the only major party in the country. The xenophobic tendencies in the government are still apparent in the business sector, stemming from

the communist government banishing the foreign owned businesses who were heavily exploiting the population. This distrust of foreign businesses and keeping power consolidated within the country has been a major influencer in the creation of the many barriers to entry for foreign investors in China. Through an interview with a popular foreign correspondent with The Economist who has lived in China for over two decades, Ted Plafker talks about the struggle with government ownership when he states, “The government will also keep control over the legal system, and many of the most strategically important industries. Telecoms, power, railways, and the media, which is both a commercial issue and a civil society issue” (“Lessons Learned in China”). This combination of a communist government with free market ideals has created a difficult place for investors as businesses have been and still are in the battle between old communist rule and the newer capitalistic economy. Influences are seen on either side as China struggles to find its identity in the global economy, which leaves the businesses in turmoil as they struggle on how to penetrate and succeed in China.

2.4 Strict Regulations

China is still considered by most international scholars as a highly regulated police state, which stems from the authoritarian one party system. This type of rule is just a modern version of government, stemming from centuries-old emperors who held a tight grip on its citizens (“Doing Business in China” 48). With this rule, they have shaped business regulations in heavy favor of domestic enterprises, who only allowed foreign business deals since the economic reforms in the 1980’s. These regulations gave leeway for businesses to enter the market, and currently have been expanded as China experienced their economic boom. Still, countless challenges are presented to foreign investors because of the pro-domestic approach by the government.

3. Barriers to Entry

3.1 Restrictions on Foreign Direct Investment

A major way of excluding foreign investors is simply restricting foreign investment in certain industries. Though China experienced huge economic growth through the transition to a capitalist economy, remains of the state run communist economy persist in various business sectors. The service industry in China is largely still under the protection of the government, which is obstructing most foreign investments and businesses from entering the marketplace (Hamlin). The services industry is comprised of almost everything outside of manufacturing, which makes the industry a huge opportunity for growth and foreign investment in a budding nation. China has increasingly put barriers on the service industry, even though foreign investment over the past 30 years brought China's manufacturing industry into the giant it is now. Though, there are multiple emerging sections which are becoming available to foreign businesses as the middle class is emerging. The government has kept a tight lid over sections of the service industry, which is a major barrier that deters many foreign investments and businesses. With the growth of the manufacturing industry decreasing in recent years, a major barrier investors will face is penetrating the service industry. This hinges almost solely on the government's decision to stop protecting domestic or state-run businesses.

The barrier of government protected industries is tied down by the relics of the past; the state-owned businesses that dot the economic landscape continue to lack the efficiency that private businesses would never have tolerated. The reason the government protects these industries from foreign investors is because they do not want to harm their own state-owned companies. This is exactly what occurred under Mao's reign, where collectivism took hold and companies could operate with no checks or balances because of the absence of competition. Where largescale manufacturing was allowed to be foreign backed after the economic reforms in

the 1970's and 80's, some businesses in the service and other industries have been still restricted. Obviously, the government ensures these state-owned corporations have no competitors so they can thrive, which would allow the government to directly control their economy through these massive corporations. The majority of these businesses fall under raw material, infrastructure, aviation, shipping, and telecommunications.

The state-run companies are also largely failing as a whole, which is a mirror image of what happened in the 1950's and 60's. With no competition and almost limitless resources by the government, the companies are grossly inefficient. Often operating at a sizeable loss and at an efficiency that no privately-owned company could stay afloat on. An example of this situation is the state-run company Cosco, which is in charge of building some of the world's largest container ships. Even with the sharp decline in recent years of global shipping, Cosco is still creating eleven new container ships; three of these are slated to be the world's largest once they are created (Wildau). There is no need for these massive container ships to be built with the world's decline in global trade, but China wants to keep forcing its economy forward. This artificial management of the economy cannot work long-term, and eventually major austere regulations will be put into place to keep it in check. This situation of state-owned businesses makes it virtually impossible for foreign investors to penetrate certain industries in China. By not allowing competitors, this severely restricts the impact and opportunity for foreign investors. While there are some workarounds to the system which will be explained later, foreign investors simply will not be granted access to these industries. But through looking at what is happening with those companies, the near future could hold an expansion of privatization within these industries.

China was forced to privatize some of their major industries after the failure of the Great Leap Forward and other economic disasters. China is facing the same vast inefficiencies that occurred half a century ago again in these state-run businesses. If these companies continue to fail, the government may be forced to open these up to foreign investors to create efficient companies. The communist government has previously made the decision to strictly regulate these industries, but may be once again forced to relinquish control in order to keep the economic progress China has enjoyed over the last three decades. While there are no straightforward ways around this huge barrier to entry, the current system is failing; foreign investors could see an easing of regulations in the coming years, which would allow investment to flow into these once restricted industries.

3.2 Anti-Monopoly Law

Similar to the barrier of state-run industries, China has recently imposed a strict anti-monopoly law to control foreign investment within the country. With the rise of the market economy in China, authorities have begun creating new agencies to control the new freedoms that were awarded to businesses. The Anti-Monopoly Law (AML) was established in 2008, and was praised by the rest of the world as a leap forward into fair business practices in China. As the law matured and its implications felt, the law appeared to be just another way of keeping foreign business under the control of the government. While China fervently disagrees with this assumption, foreign companies have been feeling the pressure as China's anti-monopoly agencies continue to levy fines and make the foreign companies feel unwelcome. When reporting on the topic in 2014, the Wall Street Journal stated, "A survey by the American Chamber of Commerce in China released last week shows that 60% of companies feel less welcome in China than before, a sharp increase from 41% in the previous poll a year ago" (Jie). Many

incidents have occurred in since the inception of the Anti-Monopoly Law that have targeted major foreign and U.S. brands. Microsoft, Qualcomm, BMW, Audi, and Dailmer have had their offices raided by government agencies acting under the AML. This has even become somewhat of a display of force, involving as many as a hundred Chinese officials storming into the companies without notice. The consequences of these investigations have included hefty fines and major price reductions on products, such as the price of Mercedes within China (Jie). These agencies have given no choice for these companies as they are accused of price fixing among other monopolistic crimes.

This new and growing barrier for foreign businesses operating in China has given a clear message to corporations looking to expand their business in China. When talking about the forceful way the AML is being executed Colin Shek exclaims, “Powerful state government departments have investigated dozens of foreign firms over alleged anti-competitive behavior, adding to broader fears that the business environment has turned chilly for outsiders.” This major barrier is mostly targeting the very large global brands which can have a dramatic impact on the economy. The communist government is always looking for ways to grab more control of the economy, and this law is a great way to allow the agencies to influence the economy through regulations, fines, and price manipulation. Ted Plafker discussing the lopsidedness in government rulings against foreign businesses when he explains, “It is often foreign companies that are first to be hit with enforcement on labor regs, sanitation regs, and pricing regs“ (“Lessons Learned from China”). Experts consider the tighter control over these consumer product companies is a way to gain more favor in the eyes of their citizens (Jie). By accusing the consumer companies of inflating prices and controlling the competition, the agencies can force the businesses to lower prices in order to stay in business. The result of this is cheaper overall

prices, which is big advantage to the growing class of consumers in China. This situation makes the regulations appear as if the government is pandering to the consumers as liberators of the foreign business, who are holding the middle class hostage with high prices.

This view strengthens the connection of the fear of outsiders and reliance on the government to protect them from outside influencers. A lot of these changes favor the consumers themselves in the outcomes, while subsequently punishing foreign companies. This creates the mentality that foreign companies are targeting and hurting the Chinese consumers, which can breed distrust in these global brands. The law is almost always enforced when foreign companies come into contact with domestic Chinese brands in competition, which again shows favoritism towards the domestic companies.

While all of this information seems bleak from a foreign investor's perspective, there is an upside. The international business community operating in China has been putting formal complaints through trading organizations, such as the U.S. Chamber of Commerce, European Union Chamber of Commerce, and America Chamber of Commerce (Jie). These organizations have recognized the significant barrier for foreign companies operating within China and the possible discrimination. After international pressure China has begun defending its position on the AML, and have been actively increasing pressure on Chinese domestic firms. This has recently resulted in fines to domestic businesses as the country tries to better control their business laws with an unbiased approach. This standardization of the AML can actually prove beneficial for global businesses who funnel significant resources towards understanding business law in foreign countries compared to the newer Chinese businesses with less resources. The previous problem with China was their business laws could be manipulated by the government at any time to fit their goals, and now this is starting to change. While businesses entering the

Chinese economy may be able to already understand these new standardized laws, the domestic firms might have a learning curve that foreign businesses can take advantage of.

3.3 Regulations and Bureaucracy

Even if a company believes the other barriers will not affect their business because they are too small or not related to China's state-run businesses, the process to formally create or expand a business in China is convoluted and risky. In 2015, China ranked 90th for ease of doing business and 124th for starting a business in the global rankings done by World Bank Group (McMunn). For being the second largest economy in the world, this is extremely low and further explains how China has a long way to go to be more business friendly. The direct way is going through the government as a foreigner and going through all the necessary steps. While the government claims this can be done in as little as 30 days, the reality is much longer and confusing than they advertise the process as. For a small company with no expertise in this area, the creation process is a legal minefield that is almost impossible to navigate. The government will also actively block businesses they do not want in the country with little to no reason because of the lack of clear regulations in the country pertaining to the creation of foreign owned businesses. This leads many to take a much shorter but very risky route, which is to partner up with a Chinese citizen who has a much easier time passing all the conditions. This is very dangerous because there are no formal partnerships in place with the citizen, so they could easily take the business and leave the business partner with nothing. The process on officially entering the market is riddled with roadblocks designed to keep companies from freely entering or creating their business in China.

The legitimate way for foreigners to expand or open a business in China is to follow certain steps before being cleared to get the necessary registration and permits to start doing

business. This process in the hands of a single proprietor is a massive undertaking because of the difficulty to just communicate with the proper agencies and understanding the laws and processes. Many companies will have a solid legal team that is well adept to working overseas with other the different country policies which will mitigate the overall process. There are also different standards for opening a business depending on what area of China the company is going to be based in. For instance, business friendly Shanghai has 8 steps for creation while Beijing has 14 steps. In the capital, the 14 step process is three times longer than the worldwide average of 4.7 steps according to the Organisation for Economic Co-operation and Development (OECD). This goes to show how China has created a difficult environment for foreigners to enter the market. Foreign businesses are required to go through many more organizations and agencies, which involves a lot of knowledge and time to navigate the different operating procedures within each particular area. This creates constant confusion unless a whole team is dedicated to understanding the confusing entry procedures. This is a main reason many larger companies will hire consultants that have knowledge to deal with each area of the multistep process in order to go through the steps as easily as possible (McMunn). There are actually quite a few companies that specialize in just this one area because of the amount of businesses who have considerable trouble entering the market. The official recorded time for a company to open in Beijing is a mere 37 days, but this is the absolute minimum time required to open a business which most foreigners will never experience (“Doing Business in Beijing, China”). Most companies are going to be looking at least double the minimum time, and that is only if there is a team wholly dedicated to the process.

Many companies will face some obstructions to the process, and some of the issues raised are seemingly very objective. For many of the necessary certifications and legal documents, an

official signature is needed from the owner or CEO of a company in order to pass through to the next step. This seemingly easy task is responsible for weeks of additional waiting time because of how the officials will judge the signature to ensure that the writing is uniform, legible, and an exact perfect replica of any other documents the signer has done in the previous steps. The signature must be an exact match with the previous signature or the document will have to re-sent to the company to be redone before being sent back to the regulators (McMunn). This seemingly simple task is made painfully difficult and wastes precious business time away from the eager companies. Similar barriers are littered in the whole approval process, making the opening of a business slow and agonizing as companies are longing to start work in a country where plans could have been made years in advance. Some of the other areas where regulators bog down the approval process are obtaining an official Chinese bank account, authorizing for invoices, and filling with the local enforcement authorities. This again creates an unwelcoming environment for incoming businesses which portrays discrimination and an uncanny amount of government regulation and oversight. In order to get an expedited approval or an easy entry into the country for businesses with insufficient legal resources, there is a hazardous approach that can easily end up a disaster.

Partnering with a Chinese citizen is by far the easiest way to enter the Chinese market and establish a business. Chinese citizens go through the approval process much quicker and with far less scrutiny than foreigners face when going through the same procedure. They are already registered in the country, have a bank account, and are listed with many of the necessary government departments when they are born, which makes the long 14 steps much shorter. In many cases, working with someone you trust in China culminates in a very profitable partnerships in which both sides are happy and reeling in high profits. A key concept in China is

trust and a positive working relationship, and Chinese businessmen will generally stay true to their partner if they have a good relationship. If not, even formal deals may be broken and have no bearing in a culture where personal business relationships are highly valued. If relations go sour, the Chinese citizen can then easily cut ties with the foreign partner. On top of that, the foreign partner is virtually powerless because the Chinese citizen holds all the legal ownership of the company in China through the documents they signed for through the creation of the business. Even if there was a formal agreement in China, the government will most likely side with their own citizen rather than a foreigner. This situation has happened with poor but also good healthy business relationships if the partner gets greedy and realizes the power they have over the foreign partner. There are plenty of examples of this happening throughout the world with partners in China, so this risky way of starting a business is highly discouraged. While some of the time it works wonderfully for every party involved, the agreement can end in turmoil with the foreigner being badly burned in the process. Going through the official process might be tedious and frustrating for foreigner, but the method is advisable compared to the other option of relying on verbal promises.

3.4 Corruption

Asia is marked by the high corruption that plagues many parts of the Asian continent, which is a prevailing reason for companies choosing not to enter the market. Corruption can cause plenty of problems in the business world which many companies choose to avoid even amid the prospects of high profits. The risks involved are speculated to be too high for some businesses to even attempt to get past the other barriers to entry. Corruption is viewed as hurting businesses and the economy by creating instability, inefficiencies, hurting development, and increasing business crimes. China has been dealing with high levels of corruption for some time

with some hopeful signs of progress, but with no real evidence to back up the plans to combat the epidemic in a country which has grown faster than its policies.

The lack of transparency in China has been a major cause for concern in the global community as a whole over the past decade and a half. This transparency hurts businesses in many ways, and especially for new businesses struggling to learn the system they must comply with. One of the largest issues in the global community is the accusations that the Chinese government is manipulating the exchange rate of their currency resulting in a weak renminbi (RMB) or yuan. This is done in order to stimulate China's massive amounts of exports, but this in turn hurts American and other foreign manufacturers because of the high value of the dollar and other foreign currencies compared to the artificially low RMB. While this does help companies that export from China, it creates instability because this situation could cause foreign governments to impose sanctions on China and its exports. One more benefit that is a consequence of the yuan manipulation is that it allows China to artificial shelter China from economic influences outside the country. This can be seen as the economic downturn starting in 2008 damaged many of the global economies around the world, but was buffered in China because of their control over their currency. This helped businesses stay afloat and profitable during this hard economic time.

Though it is apparent of the manipulation, China has no transparency on this issue stating they do not directly manipulate their own currency compared to the USD. Another major issue for businesses is the lack clarity in the business laws and the long approval process. As mentioned before, the laws governing businesses are very vague with plenty of room for different interpretations. This creates the ability for government officials to judge the laws differently, giving them more power while leaving businesses in the dark on how to follow the

laws. And with many different governing bodies interpreting the law differently, this gives businesses little time to adapt to the ongoing changes as they struggle to understand how to stay within regulations. The lack of transparency can easily allow for corruption within these organizations as they can bend the law to fit a competitor's agenda. The lack of transparency is something China has been trying to improve on as they look for ways to crack down on corruption within the country.

The lack of checks and balances also has enabled the rise of corruption in China, leading to an abuse of power within certain organizations. This negatively affects businesses as companies like Mercedes and other large foreign based businesses who are often caught in the middle of corrupt business practices have found out the hard way. Without having any checks on the regulators who are enforcing the laws, bribery, facilitating payments, and excessive gifts are often used in order to gain favor or just even to perform their normal duties. This is illegal for many foreign companies to do, such as for the companies based in the United States, and causes major concerns for companies trying to work with the regulators. This is part of the reason that a reported 25% of companies avoid doing business in China because of the concerns with corruption inside the country (Song). While this is much better than other areas like Africa or the Middle East, China leaves much to be desired in being an inviting country in terms of their vague business laws.

China is aware of their corruption problem, and have been under substantial pressure from governments around the world to fix their practices and stance on corruption. This is something President Xi Jinping has begun acting on by initiating a widespread anti-corruption campaign. This campaign has been very aggressive since its start in 2013, causing repercussions for more than a million officials as of October 2016 (Holtz). This also includes over 180 "tigers,"

who are high ranking officials in prominent positions. Xi Jinping is taking this crime and duty to clean up corruption very seriously with substantial jail time and even immediate death sentences for those who committed more serious acts. This death sentence was recently given to a Communist Party secretary in southwest China for bribe payments accumulating to nearly \$38 million (Holtz). This illustrates how the government has recognized a serious problem and is willing to go to great lengths to fix it.

Nonetheless, China is still lagging behind other large economies when it comes to corruption levels. According to Transparency International, a leading corruption watchdog, China fell in the rankings from 80th in 2013 with a score of 40 to 83th in the most recent 2015 results with a score of 37 (“Corruption Perceptions Index”). So while there are big headlines when it comes to corruption within the Chinese government, corruption watchdogs still agree on the high amount of corruption still present. This makes business dealings much harder, and can easily place foreign firms at a major disadvantage. There is still hope in the future as the current president is determined to root out corruption at every level, but it may be harder than it first appeared. The corruption ingrained in the society makes for an uninviting environment for foreign firms, especially if they are not familiar with the business landscape.

4. Advantages of Operating in China

4.1 Rise of Consumerism

The rise of the Chinese giant has also created an emerging middle class who are bringing consumerism to China on a larger scale than ever before in recent history. Since the boom of the Chinese economy more than a decade ago, the middle class has grown by leaps and bounds, and will soon have a larger middle class than the United States in terms of sheer number of people with 109 million. According to recent research data, by 2022 “more than 75 percent of China’s

urban consumers will earn 60,000 to 229,000 renminbi (\$9,000 to \$34,000) a year” (Barton). This is comparable in purchasing power parity to Brazil and Italy who both have large economies, and Brazil is also a rising economic power with a growing middle class. To illustrate this massive growth, only 4% of the urban population fell between this range in 2000 compared to the 68% of the urban population in 2012 (Barton). The rise of the middle class is a huge advantage for sustained growth in the economy and also a considerable amount of potential consumers for companies to market to. This is a great opportunity for companies based in China because they can also target this growing class for products in addition to an already bustling exporting business.

This rise to power has continued to fuel China’s sustained progress becoming a real power and voice for the transforming country. The consumer spending in China has recently exploded over the last decade, which in 2015 has made China the 2nd highest in the category with \$4.2 trillion (Iskryan). This substantial growth has created a healthy domestic market to match their global exports. Furthermore, the consumer spending is expected to grow by an astonishing 55% from 2015-2020. At this pace the Chinese economy can quickly catch and surpass the United States in the near future, which could fuel more US exports of high end products. Businesses have been quick to react to the new tide of domestic consumers, making thriving metropolises and massive shopping centers within the many major cities dotting China’s landscape. While the middle class is classified by earning between \$9,000-\$16,000 which may not seem like a lot, when accounting for their purchasing power parity the income lines up roughly with other major countries around the world. The boom in disposable income has been staggering over the last three decades with the amount in 2010 being ten times more than in 1980 (Exhibit 3). This is also expecting to grow in the future allowing for more disposable income to

be spent on consumer goods. This growth in the middle class has allowed for companies to expand their operations to look inward for consumers as well as abroad. This can even cause a shift from major companies primarily focusing on domestic buyers compared to the global market because of the emerging middle class which is currently booming.

This situation is obviously a major opportunity for any company looking to operate or manufacture in China. With a middle class of 109 million people that is expected to grow to over 500 million within a decade, the market for goods in China will quickly dwarf consumer spending around the world (Exhibit 4). Companies have already been looking to capitalize on this massive number of consumers within a country which is already a manufacturing powerhouse. While many view the United States as the undisputed business leader with companies like Walmart, EBay, and Amazon, China has produced the largest online retailer in the world relatively quickly. Alibaba was created in 1999 and has now surpassed Walmart in worldwide online sales where nearly a trillion US dollars were spent in 2015. On top of that staggering number, Alibaba has recorded \$11 billion in profit compared to Wal-Mart's combined profit of \$4.5 billion in 2015 (Tong). Americans have not fully embraced the new commerce store, but Asians have been flocking to the website for years now as the online commerce has just recently exploded within the continent. This has largely been in China where Alibaba is headquartered, which is aided by the large growing middle class. This illustrates how the market is diversifying to online sales as well as physical retail stores. This is definitely a major advantage for companies looking forward to the millions of new consumers who are entering the middle class every year. Alibaba is just one example of the booming businesses that are taking full advantage of this new consumer group. The growing middle class doesn't just allude to China as it does to the whole of Asia who is quickly becoming the next round of economic

powers with the likes of India and the Philippines. China and India account for roughly a third of the worldwide population, and they host the largest pool of middle class consumers. Having a business in China where manufacturing centers are already grouped together would make distribution to cities in China and nearby India much easier than other global businesses.

In addition to the opportunity for the large manufacturers to retail to the robust new market in China and the rest of Asia, the emergence of the service industry makes China a perfect place to introduce service based business to the middle class. While portions of the service industry are still closed to foreign businesses, many are quickly becoming available to foreign direct investment. The large amount of disposable income is being spent on new luxuries in the service industry, which foreign companies can easily exploit by opening businesses in China. The middle class is stimulating immense growth in the market, creating the necessary environment for a sprawling consumer market mirroring the United States in spending. China is not constrained to only manufacturing because now the country can look internally for sources of income instead of solely foreign markets. This greatly expands the potential revenue and consumer base by millions, and also makes the process actually easier because of the fewer legal issues as well as simplified logistics. Companies entering the service industry would find it easy to attract the large number of urban dwellers who comprise most of the middle class within China. Beauty services have already been a huge success in China, and other services can find success in looking towards the needs of the middle class as they find new freedoms which they have not experienced in decades through the transition to the Communist government. While many foreigners neglect to see the potential for consumer products and services in Asia and particularly China, this market is on track for certainly becoming the largest in the world and cannot be ignored by any global brand or rising company. This advantage is mostly overlooked

by companies moving to China only eyeing the cheap labor and large industrial parks, but the middle class should actually be the focus for businesses looking to expand into China.

4.2 Access to Massive Industrial Parks and the Labor Force

China hosts industrial parks the size of large cities in which multiple parts of the supply chain are housed within close proximity to each other. This structure is conducive for many large businesses because of the ability to transport parts and supplies to other businesses in a matter of minutes compared to days or even weeks which some global companies are forced to wait for materials from across the globe. Having greatly improved the infrastructure in the country over the last two decades promoted the creation of massive industrial parks and cities where supplies were previously hard to reach. Now, with an improved infrastructure, supplies and raw material flow freely throughout the country. This allows for industrial parks to use land which was previously unusable, and land is a very valuable resource in a tightly packed country like China. Gigantic industrial zones and parks were created to take advantage of this resource, and groups of large businesses are situated in these parks separated usually by industry type. This provides businesses an opportunity to join the industrial complex and more or less provide a convenient one-stop-shop for anything associated with that certain industry. Opening a business in one of these industry specific parks would dramatically shorten response time for ordering products and severely cut transportation time. Many companies have already taken full advantage of these complexes such as Apple. For instance, a company can just go next door if they are short of 500,000 screws or electronic resistors. Having multiple points in the supply chain nearby is a great advantage companies cannot overlook when opening a business in China. These complexes can be over 100 square miles with a population of 2 million, as is the case with China–Singapore Suzhou Industrial Park. These areas are basically packed with businesses looking to work with

each other as a cooperative effort which benefits all parties involved. In addition to the large scale manufacturing of low-tech commercial and industrial products, China also hosts a large amount of high quality advanced electronic industrial parks. These places often have high quantities of skilled laborers to match the more technical work, which is something highly desirable when picking a location. For virtually any industry, there are large business complexes that combine different parts of the supply chain together for more collaboration, ease of transportation, and reduction of costs.

In addition to the variety of complexes dotted around China, the workforce in these areas are also desirable for any business looking to capitalize on China's inexpensive and skilled laborers. Having a vast supply of cheap laborers was and still is a central theme in investing in China, which first began around two decades ago with many global companies seeking entry into the country. China has a total workforce of around 900 million workers and many of them are still cheap unskilled laborers. This itself is a massive number even compared to the United States, with a large current workforce of 160 million. For any company looking for cheap manufacturing, China has been the main target for many foreign based companies. China's large workforce, who many still have low wages, creates a large opportunity for companies looking to dramatically lower manufacturing costs. Many companies relocate their businesses to China, but still have their main target audience in U.S. adding to the largest trade partnership in the world. The exploitation of this cheap labor helped create the world's largest trade partnership between the world's largest exporter and importer, which is valued at a \$660 billion in 2015 ("China - United States Trade Representative"). This wouldn't have been possible without the low wages paid to many of the workers found in the industrial parks. The minimum wage is determined by each province, but some of the lowest minimum wages are less than \$2 an hour or \$150 per

month. The minimum wage has been increasing over the last decade, but is still significantly cheaper than the cost of factory workers found in the U.S. and other countries. The industrial parks house many of these workers who permanently live there for their whole lives in the massive city-like locations.

The combination of the specialized and cheap workforces within the industry specific industrial parks creates a favorable environment for any manufacturer who can lower their costs while gaining valuable resources from other nearby plants found in their value chain. The industrial parks are the size of large cities, and they specifically cater to businesses in order to fuel growth and provide employment for the population. This favors any business who desires to move to China and can take advantage of this perk. Having access to a large workforce eager for work coupled with condensed industry specific companies just adds to the appeal to move a business overseas. While other countries might have cheaper labor costs as the standard of living rises in China, the other benefits found within the industrial parks is seen as more desirable than just the lowest labor costs. China realizes this benefit and is currently working on improving the infrastructure to better cater to these companies, and make the transportation of goods even easier within the country. By investing in these industrial parks, China is helping bolster their economy and is building the middle class through the higher skilled occupations.

4.3 Special Economic Zones (SEZs) and other Free Trade Areas

In addition to the sprawling industrial parks, China also created business oriented areas located around the country to promote business and even encourage foreign businesses. China has long understood the importance of a capitalistic society and the benefits of privately owned businesses since the 1980's. The leaders also recognize the importance of foreign businesses even if some areas of the government oversight restrict the amount of foreign business influence

in the economy. This led to the creation of the zones in the 1980's to better accommodate free-market ideals by giving more economic freedom and less government restrictions. This combination has made the areas foreign business friendly along with other added benefits to escape the severity of regulations coming out of Beijing. The zones have become pockets of increased economic activity because of the large amount of business being conducted there with the influx of foreign and domestic businesses. Without foreign business injecting modern technologies, processes, equipment, and capital, China would still be lagging behind in the global marketplace. The zones were designed to build bridges between China and modern foreign companies to close the gap in technologies and other relevant business advancements (Dixon). The zones are very important to the growth in China, and the local governments are targeting foreign businesses in order to encourage investment in these specified areas. There are a multitude of benefits for moving a business to these zones, which should attract the eye of any investor looking to expand their business to China.

One of the biggest advantages of SEZs for new companies looking to enter China is the reduction of approval process for companies moving to China. As mentioned before, China has some of the longest and convoluted steps in the approval process making sections in China unfriendly to foreign businesses. The special economic zones mitigate the process because they do not have to follow the stricter regulations from the governing bodies over them. This has made the transition to China much easier than the traditional process. This would be a great way for companies that have low resources or not knowledge of the Chinese approval process to gain entry into the Chinese business market and enjoy all of the benefits without one of the largest barriers to entry. These areas are governed by their own business friendly laws, so the confusing

steps for approval would be cut out and the officials reviewing application are much more lenient than their counterparts outside the zones.

These zones can also offer other incentives for businesses to take advantage of, which can aid new companies looking to expand in China. These zones can reduce or eliminate the national tax for businesses found in the special economic zones. This can be a major advantage for companies looking to save money by moving to China because the corporate tax rate (CIT) is 25%. The elimination or reduction of this tax rate in the zones would give companies just another reason to have their business in China. The 25% CIT is already low compared to countries like the U.S. with the highest CIT at 39%, but further reducing this adds additional appeal to these economic areas. Even with these benefits, the economic zones are also business friendly by adding preferential treatment by the local governments who recognize their importance and give the companies more autonomy in running their company. Finally, the other major benefit in these areas are the generous views on export and import duties, which are critical for many of the manufacturers found in China. The duties or tariffs are greatly reduced because they are necessary for many of the companies, and by eliminating or reducing them this greatly improves business productivity (Dixon). By reducing these tariffs, the economic zones mitigate any reservations from businesses hesitant to moving to China because of increased costs in tariffs or trade duties. These special economic zones hosts several important benefits that businesses need to consider when looking into China, and even bolster many of the already great benefits of doing business in China.

While the Special Economic Zones have the most benefits in the country, many other development areas are present around China to increase business activity and help foreign companies entering the country. SEZs are just one part of the overall economic development

zones in China which are comprised of various zones with more business friendly tendencies. These zones can be classified by the type of economic zone and by the government body governing them. There are many different types of these zones, so research must be done to understand which zone is the best fit for each individual company. Many are industry specific and cater to a certain type of business through reducing trade or tax barriers. For instance, there are high-tech industrial development zones, free trade zones, export processing zones, bonded logistic zones, coastal cities open to foreign investment, and other more specific areas (“Understanding Development Zones in China”). These zones have been incredibly important to China’s economic success as they invited foreign business through using these zones as foreign friendly places to expand businesses. Businesses should closely study these different economic areas before choosing the right one for their business as they are tailored for each industry. The zones offer a way to get around many of the strict laws imposed on foreign businesses while enjoy the benefits of Chinese business without all of the strings attached.

4.4 Momentum of the economy

China entered the world view around two decades ago and have displayed their economic standing marked by tremendous amounts of growth. China’s economy has recently exploded with the GDP growth reaching into the double digits. This brought more investors in as they wanted to cash in on the rapidly growing economy as China’s GDP grew from \$734 billion in 1995 to \$11 trillion in 2015. The growth during this period is something the world has not seen since the industrial revolution. This amount of growth has brought approximately 600 million people out of poverty, which also means economic improvement on many fronts (Purdy). Companies who are an active part of the growing market share in the growth of the overall economy, which companies are chasing when faced with the slow growth of the developed countries in Europe and North America. In the early 1990’s and the 2000’s leading up to the

global recession, China was boasting with double digit growth numbers with close to 15% GDP growth. This itself was enough for many business to jump ship and relocate to the prospering businesses in China, but recently the GDP growth has been slowing down. While many see the slowdown of the economy as a negative, the growth is still currently at above 5%, which is much higher than many of China's competitors. This rate is supposed to remain steadily above 5% for at least the near future (5-10) years. With this growth rate, China would overtake the U.S. for the world's largest economy by 2020 in terms of purchasing power parity (Exhibit 1). There is a reason that already 85 companies of the Global 500 are already in China as of 2014 (Purdy). Taking part as the economy continues to surge at above 5% a year. While the days of 13% and 14% growth are gone, China continues to put out steady growth numbers for their economy. Companies should attempt to ride along as the economy continues to grow along with the companies who supply the actual economic activity.

After trying to artificially maintain the strong growth over the last few years, China has started to switch over to a consumption-driven economy which is more situated for long-term growth. China has tried to boost the economic growth in recent years by investing billions of dollars into various areas of the economy in order to keep progress moving, but this method was not sustainable because of the substantial amount of capital needed to finance these projects (Purdy). This led to the creation of "ghost cities" and huge infrastructure projects, including the world's largest dam built in 2009. China is already on the track towards a consumption-driven economy by continuing to support the rapidly growing middle class. By transitioning to more domestic consumer spending, the pressure is off of the government and the economy is much more stable and predictable. This is good news for businesses moving to China as they are on track to maintain growth which doubles the current growth in the United States. The momentum

of the economy is steadily progressing and continuing to retain and add benefits for the companies who are riding the sustained economic activity.

4.5 Transition to a Market Economy

While China official operates under the Communist Party, they have been slowly transitioning to more free market ideals ever since Deng Xiaoping took control as the Chinese Premier. As China shifts towards the market economy, businesses are increasingly finding more freedom and less restrictions as the government is slowly handing power over to the businesses. This is not what the party wants to do, but moving towards a market economy is easily the best outcome for the economy as they look to maintain their strong growth. The transition is already fully underway in the different economic zones found throughout China who model market economy structures to cater towards the needs of businesses. This is stemming from the failed economic policies of Mao and how Xiaoping attempted to end isolationism by inviting foreign businesses into the country. The new policies made in the 1980's and 90's produced substantial results in the economy, and the current government cannot ignore the outcomes which put China on the world stage. By ending isolationism and introducing free market ideals, China has over tripled their research and development through foreign investment over the past 20 years (Purdy). China has continued to loosen restrictions for foreign businesses as they realize the importance of these companies. Though the transition has had some ups and downs as the government still does not want to give up the absolute power they once had. Overall, the economic policies have been going in favor of the business sector as business have a greater role in shaping the future of China. The new consumer driven market is almost entirely based on how the businesses handle switching to selling to domestic customers rather than exclusively exporting abroad. The transition to a market economy has more positive implications than just more lenient business laws.

China has long pegged its currency to the U.S. Dollar, starting back in 1994 during the manufacturing economic boom during the 90's. This means the Chinese RMB, otherwise known as the Yuan, appreciates and depreciates based on how well the USD is doing which essentially ties the two currencies directly together. The Chinese government pegged the currency at a much lower value to undervalue their currency, with experts arguing their currency could be devalued as much as 25% (Zack). This worked to the favor of Chinese manufacturing as the world flocked to China for manufacturing goods because of the undervalued prices, much to the disagreement of economies such as the U.S. where many manufacturing jobs were lost as a result. While this made China the world's leading exporter for a number of years, it also is the cause for political turmoil among the other major economies because of the unfair business practice. Furthermore, this created an uncertain future for the Chinese economy even though they were recording record breaking growth. This strategy could only work in the short term as they climbed their way to the highest exporter in the world, but how would this help them after manufacturing would eventually reach its cap in the global trade.

The manufacturing boom would eventually stop, which would cause a dramatic drop in their economic growth because they only grew in one sector of the economy. The pegged currency curbed any other domestic growth as their money could buy less from other countries (Zack). This severely hurt their consumer class and with the growing pressure from the world powers, China is beginning to loosen their control of the Yuan in order to make the transition to a free floating currency. The free floating currency is one of the indicators of a market economy, which is one of the reasons China has not yet been officially recognized by the WTO as a market economy. By moving towards a free floating currency, this will provide more stable economic growth by diversifying the focus of the economy to also include consumerism (Schneider).

While the overall growth has recently began declining partly due to the shift to a free floating currency, this also indicates a shift in focus for Chinese industries. This will bring about a more stable and sustained growth rather than relying on manufacturing alone which would eventually cause the growth rate to crash. The increase of the Yuan from the free floating currency would empower the consumer while providing a boost to other industries such as the service industry (Zack). By focusing on these other integral parts of the economy, this sets China up for sustained growth rather solely relying on the manufacturing industry.

The broadening of the economy is good news for investors as more opportunities are available rather than only manufacturing. China is becoming a diversified economy, which promotes growth by focusing on multiple parts and mainly promoting growth in their citizens (Scheider). Consumerism is already in full swing and this transition will continue to benefit the large growing middle class, as they can now go further on the Yuan than they have before. This creates many more business opportunities in the service industry which is easier for the smaller investors to get involved with because of the reduced capital investment. This in many cases is mimicking the history and growth of the United States in a condensed form as they transition from industry boom to a consumer oriented approach. The shift to a market economy provides benefits for many foreign investors looking to capitalize on the diminishing restrictions and the advantages stemming from the stronger Yuan.

5. Disadvantages for Businesses in China

5.1 Ownership Restrictions

China has been struggling with the privatization of certain sectors since the death of Mao and the eventual shifting to privatization and a market economy. The ownership of different business ventures and land has continued to be a problem where the government is having

problems passing power to individuals and businesses. During Mao's reign, the land was entirely owned by the state with no room for individual ownership until after his death and the beginning of free market ideas. Furthermore, the process for ownership of companies in China is still tricky, with many companies having ownership through variable interest entities (VIE). This involves a long process of owning Chinese assets through other companies owned by Chinese citizens. These ownership rules cause headaches for business who are investing a lot of capital into a foreign country, and also have uncertainty about the full implications and safety of their investments. The ownership restrictions and complexities remain a real disadvantage for companies looking to invest overseas in China's economy.

Ownership of the land within China has continued to plague companies who are investing millions of dollars in buildings and factories that are built on government leased land. This has long been a major discussion point between businesses and the Chinese government prompting the passing of the Property Law of the People's Republic of China in 2007 which laid out the legal terms of land ownership in the country. The law kept many of the property rights with the state while simplifying the laws with leasing of the land to businesses and foreign owners. While all land is either directly owned by the government or in rural settings by collectives (remains of collectivism), individuals and businesses can purchase leases of the land for a certain period of a time and reapply for the leases when the time is up. The current setup for the property rights is based on the use of the land, which is then tied to a fixed-term lease according to the application of land. While residential properties have a lengthy 70 year lease on their properties, industrial and most of the other for-profit uses are capped at 50 year leases ("Unstable Foundations"). While this may not seem like a major deal, for a company's long-term business strategies this is a major deal with deciding whether to build their own industrial buildings or rent them.

There have already been a few examples of what will happen at the end of these leases for companies and home owners because of 20 year leases created at the beginning of the economic reforms of the 1980's which just recently expired. The land in China has much better value than the aging buildings that are built on them. While the land has been appreciating, the buildings themselves have been depreciating since they were built, leading to a problem for the companies who built the structures. In 2004 the Shenzhen government set a precedent for future leases by requiring those businesses who leases were up to pay 35% of the property value for a 40 year extension, and they were only compensated by the greatly depreciated value of their development on the land if they couldn't pay the new lease ("Unstable Foundations"). This incident that occurred made many speculate the buildings were worth very little without owning the actually land they were built on. The term "castles in the air" was created illustrating the fact that the land made the building valuable and without it, the buildings were essentially useless. This is a major cause for concern for businesses who have made major investment on buildings and factories built on government leased land. Additionally, the government may even revoke the extension for the lease depending on what is deemed best by the "public interest." Many foreign businesses have voiced their concerns about this issue to the Chinese government and their home government to put pressure for changes, but only vague answers have been given on the issue. With the earliest leases expiring in the 2030's there is still time for progress to be made on the issue, but until then foreign and domestic businesses are holding their breath for the potential of losing their plant and equipment assets.

In addition to the question of ownership of land, the ownership of companies also is a complicated process found in many businesses in China. Joint ventures are common in China to bypass many of China's strict rules against foreign investment and even the industries which are

protected from foreign direct investment. This leaves foreign companies wanting to invest in China without a way to directly expand their business in China, but companies still find a way through the barriers in order to invest through a process similar to joint ventures. By partnering with these state-owned companies, capital and industry knowledge can be transferred to the companies for a stake of the business. This creates a mixed ownership model where state and private investors are a part of the same company and work together. In addition to an actual partnership, this can be done through a process called variable interest entity (VIE). This is where capital is given to a Chinese company by a foreign investor or company and through a series of contracts, a portion of the profits are delivered to an offshore bank account and then to the foreign investor (“Who Owns What”). While this might seem like a positive for companies finding a way around the government restrictions placed on foreign investment, there are many downsides to this process.

The process by VIE is in itself risky only securing the partnership through a series of contracts that are based in China. This means that if there is any conflict between the two sides, the government is likely going to side with the Chinese company or individual. This can be a major liability for companies looking to invest through VIEs in cases where there are too many restrictions within that certain industry. For the VIEs and other partnerships with state-run companies, there are additional risks that companies need to be aware of. The state-owned businesses who foreign investors are partnered with are often the ones calling all of the business decisions. Even if the foreign company owns the majority of the shares, the state-owned business is wholly in control of itself (Meyer). These companies may be state-owned but in many cases they are strictly state-run as well, serving the best interest of the state rather than tending to the needs of the actual business. This creates a lot of tension for the companies that engage in these

“partnerships” where it is usually very one-sided. In these mixed ownership companies, 90% of private business leaders said they felt they had no influence as board members within the company (Meyer). This makes it clear that the mixed ownership model is hardly ever a good idea, and in addition many of the state-owned companies will gladly take the capital and IPR from the foreign investors but will never give up a controlling stake in the company. This illustrates the murky topic of ownership rights in China for foreigners looking to invest; the political climate has made ownership for foreigners difficult and misleading with the uncertainty of the land leases and the drawbacks of the mixed ownership model.

5.2 Intellectual Property Rights Violations

A major disadvantage that many businesses are facing when going into the Chinese economy is the amount of intellectual property rights (IPR) violations that commonly occur in China. This issue is very real for many companies with any proprietary ideas or products. China uses this information to make similar cheaper price products, or in many cases Chinese companies will blatantly produce counterfeit products using the foreign company’s logo. China is by far the largest producer in counterfeits with 87% or \$461 billion being produced and exported around the world in 2013 (OECD). This creates concerns for any company looking to move to China because of risk of violations against IPR. While many companies already do lose business secrets and proprietary information even when based in countries outside of China through hacking, having a business inside China makes the process much more susceptible to attacks.

This is especially dangerous for young companies with a good idea but little brand recognition because other products violating patents can easily produce a product at a much cheaper price and maybe even comparable quality. This can render a new company useless as they were just surpassed on price and quality without having a brand name to back them up.

China is already known for stealing many U.S. and other foreign company's secrets through hacking and reverse engineering. This causes many companies to stay the farthest away from the center of this corporate espionage and source of counterfeits and rightly so. This same occurrence has also caused some businesses to be forced to move to China in order to maintain an advantage over the reproduction products. If a company has a strong brand name but an easily duplicable product, they may need to move to China to use to cheaper production costs to combat the replicas.

For larger companies looking to partner with domestic Chinese businesses, this is a very real danger that often culminates with a loss of IPR. Foreign companies are often forced to partner with domestic businesses in certain industries to maintain domestic power, with the foreign based companies providing IPR and capital. As many companies have found out, these partnerships are usually one-sided and result with the foreign company backing out or being forced out by the domestic business. Now, the domestic company has the IPR of the foreign company and can reap the profits without being hindered by the foreign ownership. There are certain steps to take for companies moving to China in order to protect their intellectual property. Through trial and error, companies have learned to bring older technology to China, leaving sensitive information at home, charging for IP upfront, and choosing more reliable business partners (Bosshart et al). By following these suggestions, these steps can mitigate any infringements from foreign partners or competitors.

Having a \$461 billion industry in your country vastly helps your economy as it continues to grow and most governments would try to protect this industry which is the size of Poland's entire GDP. Counterfeiting has largely been facilitated indirectly by the Chinese government because of the state-owned banks that counterfeiters use. With 87% of the counterfeiting

occurring within China, these companies need banks that are willing to handle the transactions which are largely done abroad. Not surprisingly, 90% of the banks used by counterfeiters are based in China, and two of the largest are state-owned banks (Associated Press). This becomes a major problem when the government is involved and their companies are facilitating payments used by counterfeiters. This has raised many concerns by brands that are often illegally reproduced, such as Gucci who is suing the Bank of China for damages against the brand and lost revenue due to counterfeits in the United States. The U.S. and other foreign governments have asked the Chinese banks to freeze the assets of these counterfeiting companies during the lawsuit, instead when asked the Bank of China didn't freeze assets and took money from the companies only to cover legal fees. This appears to be another case of the Chinese government backing domestic businesses even if they are illegal in order to drive growth and protect domestic workers in a huge industry. China is again aware of the global criticism from their stance on IPR violations and counterfeits as they are trying to crack down on the illegal activities. Companies have reported that they have noticed an improvement in the government's enforcement of IPR violations, which illustrates a growing concern and a better future for companies hesitant in moving to China out of fear of these dangers (Exhibit 6). Overall, IPR are still being heavily encroached on by Chinese companies looking to get ahead by illegal means.

6. China's Economic Future

The future of China is largely uncertain with turmoil in the region in both economic and politic terms. The current president has illustrated growing resistance towards U.S. foreign policy by forming their own trade pacts, while current relations are quickly deteriorating. The U.S. is losing influence in the region by potentially blocking their led TPP trade pact and growing interest in raising trade barriers stemming from the new presidential election. This could

cause a trade war in the largest trade partnership in the world, which would spell disaster for both economic powerhouses. China will likely not enjoy double digit growth periods as their economic boom is slowing down into decreased but stable GDP growth. They have already experienced other countries filling the gap of cheap industrial countries because of the growing business and environmental regulations combined with growing labor costs. There are certainly many opportunities to grow a successful business in China, but the future of world trade is in the balance that will be decided in the near future.

Political trouble could stand to hamper economic growth and hurt Chinese businesses through potential trade sanctions or even a full-fledge trade war with their largest trade partner, the United States. One of the political topics is the trouble in the South China Sea, where China is expanding their regional military influence by building artificial islands in disputed waters that are generally classified as in international waters. The government is also claiming other islands and rushing to inhabit them to substantiate their land claim, but these islands are claimed by at least five other countries. The U.S. has been heavily involved with this dispute by publicly condemning the actions, while sending the U.S. Navy to go through the disputed territories in freedom of movement missions. This has caused tensions to rise to new highs as military altercations are becoming more prevalent. With both sides remaining firm on their claims, this could easily result in economic sanctions. The U.S. and regional powers in Europe have recently imposed harsh economic sanctions on Russia because of the illegal annexation of Crimea in 2014. These sanctions coupled with declining oil prices have effectively crushed the Russia economy with their progress grinding to a halt and their exchange rate versus the dollar being nearly cut in half. This same situation could occur in China if the U.S. decides to force sanctions which would greatly impact both countries and damage businesses on either side. The political

unrest destabilizes the cooperation between the trade partners, culminating in the potential of harsh economic sanctions.

The Chinese government is already shifting its preferential economic treatment towards other countries than the U.S. This could result in an easier entrance into China for new trade partners, while hurting U.S. based companies looking to expand their business into China. In retaliation to the deteriorating American relations, China has been quick to find other strong trade partners around the world to fill the void of decreased U.S. trade. China has already passed the China-Australia Free Trade Agreement in 2015, and is poised to continue making trade agreements with other major powers such as Britain. The destabilization of trade partners could negatively affect companies within China as they shift their focus from the U.S. to other trading partners. Even if China does shift this focus, decreasing trade with their largest trade partner would hurt companies exporting their products. They're likely to be tariffs placed on either side of the Pacific as the nations vie for power.

In addition to China's strategy of gaining other strategic partners, new leadership in the U.S. is also threatening the delicate balance in the trade partnership with China. With the next president set to be Donald Trump, his campaign promises are aligned with isolationist and pro-domestic industry principles. His thoughts on stopping the Trans-Pacific Partnership will certainly dramatically lessen the United States' power in the region, which China will be sure to take through their own treaties. Though this may seem as a positive for Chinese businesses, it will likely cause a trade war with either side raising tariffs for each other. Many companies export to the U.S. so tariffs could severely impact their business. This already growing feud is sure to create havoc among the vital trade partnership, and also will create an uncertain future for companies looking to move to China to export cheaper products to the U.S.

Finally, President Xi Jinping has favored domestic since he assumed office in 2012. While many areas of the government want more free market principles, the president has leaned in the favor of domestic Chinese businesses and restricting access for the expansion of foreign businesses. Ted Pflaker thinks this tendency will continue for the foreseeable future as he explains, “I think the trend toward favoring Chinese companies and being less hospitable to foreign companies is likely to progress further” (“Lessons Learned in China”). He has been pushing for use of more domestic technology and suppliers rather than from foreign companies, which illustrates the attitude towards allowing foreign businesses putting down roots in China. The country is trying to quickly become independent and free from international influence as they now have most of the necessary tools to do so. This could benefit companies already in China, but hinder any future attempts from major foreign companies wanting entry into the country. The uncertain future in China looks slightly unfavorable for foreign companies looking to invest within the country. Combined with the dangerous international political climate and slowing growth, foreign companies must closely consider future internal and external factors in their decision to invest.

7. Recommendations

The decision to enter China is largely based on which industry the company is in and whether that conflicts with any state-controlled industry. When looking at the industry companies should also consider what the goals of the move are. China hosts many economic development zones which caters towards each individual industry. Many individualized benefits can be found in these zones which many businesses may find enticing, such as reduced trade barriers, specialized workforces, and favorable tax rates. The growing middle class and spending cannot be ignored and companies should be looking to sell their goods domestically and not only

export to other large economies around the world (Exhibit 5). There are also large amounts of restrictions based on industry, which must be considered before moving a business overseas to China. These restrictions can be controlled even by the lower levels of government, so the location of the business is very important. Choosing a favorable economic development zone will be the best option for most businesses because of the positive relationship with the local governments who have most of the control rather than from central government powers. These are the safest places for businesses to be, as they are generally business friendly and encourage foreign direct investment.

While necessary planning is always a must for investment in a foreign market, this is especially true in China where many companies are very unfamiliar with their business process and general business norms. Companies who expect to start their business within the 30-day minimum from the approval process will likely struggle due to misallocation of resources and not allowing enough time to set up operations within China. Numerous foreign companies have found this the hard way including Google and Mattel who didn't take the time and realize what they were getting into. Companies who are flexible and allow for changes will find a much easier time in the transition into China, while business who stick to the same rulebook will flounder with the diversity they will certainly face. Plafker has witnessed the difficulty with the move for many companies and shares his best advice when he states, "A lot of things will not go according to the corporate handbook back at headquarters. It becomes a challenge to achieve the necessary flexibility with going totally off the rails of what's acceptable back home ("Lessons Learned in China"). Doing work from the ground and not from a foreign office is the best way to get results and also build relationships in a culture where strong personal bonds are necessary for business.

Being adaptive will go a long way in a when working in a completely different business environment.

For larger companies who have the resources and more at stake, hiring a business consultant is also highly advised. Because of all the complexities and government nuisances, having someone who has been living through it will help tremendously in dealing with the approval process and giving a general understanding of the business environment. Not everything can simply be researched or learned from one trip to China, and having at least one person who is highly acclimated to dealings with the government and also other businesses will help the company out more than just a large supply of capital. The business consultant should be someone familiar with the particular area of interest in China because of the differences in business laws and rules for each city or province. Each economic development zone can have unique laws which companies need to know in order to better understand all of the different factors of each particular business environment. Having someone who knows the ins and outs of an area will expedite any process, and the business and governmental relations the consultant may have will be invaluable for starting a business in a foreign area.

Lastly, while the many benefits may displayed through the allure of partnership or joint venture, this option should only be considered with caution. A multitude of companies have been burned in the past by giving away their controlling stake in a company for quick and easy access to a new unfamiliar market. This common mistake should be avoided because of the many dangers it poses for potential foreign investors. The potential loss of IPR or the resulting corporate conflict could see the foreign partner taking off with the whole business and precious business secrets or capital they invested in the Chinese company. Joint ventures have worked out in the past resulting in massive profits for companies, such as the Celanese Corporation of the

United States with China National Tobacco Corporation from their partnership beginning in 1989. If the choice is to use one of the mixed ownership options, long term goals will need to be clearly established for both sides, and the foreign based company must ensure they keep at least a 51% stake in the company or they will quickly be brushed aside. Joint ventures are very risky but sometimes necessary, and should never be a first option or freely used without a solid plan with the other joining company.

In the quickly changing Chinese business landscape, businesses must be able to look at the rising trends and answer a few key questions when deciding if moving into China is the right decision. The shift against globalization in major economies such as China, U.S.A, and Britain, has many businesses hesitant to expand into any new areas. Even with these trends and economic shifts, the underlying business objective of maintaining a sustainable competitive advantage will drive the decision to expand or to remain in their home country. Technology companies and the growing high-tech infrastructure is putting Chinese companies into more direct competition to other global technological powerhouses. With China's many business benefits, this is giving Chinese companies competitive edges over their more expensive competitors which global companies should be aware about. China is looking for more innovation in their country through domestic and international avenues, which is coincides with their rise into the high-tech world.

Furthermore, the new generation of the Chinese citizen is already embracing new technologies much faster than other parts of the world. Payment services through phones are quickly replacing even credit cards from street vendors to major corporations. The demand for solar panels in the country also dwarfs the sluggishness of the American consumer where the trend has been quick to catch on in China as their citizens are becoming more environmentally

conscious. Global brand names are still very popular among Chinese citizens as they are seen as higher quality and more trustworthy. A recent example of this can be seen in both the U.S. and China where dangerous baby formula has turned many consumers off from Chinese brand names and towards trustworthy global brands.

All of this quickly changing information has many implications when looking towards the future of China and the decision for businesses to enter the market. Even with all of the current trends mentioned, there is still a large amount of uncertainty which is largely unknown. Many of the intricacies are masked by the government and state-owned companies which are public knowledge in other countries. This creates a risky situation for businesses who cannot easily adapt to changes in a very different business environment. When looking at the economic future of China, companies need to be able to answer a few essential questions before making the decision to enter into the Chinese market:

1. Is your current competitive advantage sustainable with the new rising trends?
2. How would a rising trade barriers affect your business and global demand?
3. Is there a strong global need for your specific global brand in China?
4. How does your company compare to the modernizing domestic Chinese companies?
5. Is your company flexible enough to deal with the adversity found in the Chinese business environment?
6. How can entering China help you stay ahead of the rising global trends?

8. Conclusion

China has become a hotbed for foreign investors looking to cash in through the many favorable economic factors which created China's economic boom during the last two decades. The allure of easy profits in a rapidly growing market enticed many investors and companies to

hastily expand their business to China without properly learning about the complex business environment which China has become. Lacking the knowledge of the various and intricate barriers to entry and understanding of the advantages and disadvantages for businesses, companies could quickly fail and lose their hefty investment. By carefully learning about the multiple pitfalls and how to avoid them, this knowledge will give any business the tools they need to succeed. Companies need to be reminded that not every business can fit into China's overall economic plan, and planning based on each company's industry is essential in order to see the feasibility of expanding. While the future may seem uncertain due to a multitude of internal and external factors, China should always be considered for expansion and investment because of the wealth and potential of their growing economy.

Exhibits

Exhibit 1 – China’s GDP vs. the United States’ in Purchasing Power Parity

http://i.dailymail.co.uk/i/pix/2014/10/09/1412858241452_wps_3_Chart_comparing_China_s_G.jpg

Exhibit 2 – Grain Output during the Great Leap Forward (1958-1961)

https://www.theatlas.com/i/atlas_4JKPlm83e@2x.png

Exhibit 3 – Increases in Disposable Income in China

<http://i2.cdn.turner.com/money/2012/06/26/news/economy/china-middle-class/chart-china-income.top.gif>

Exhibit 4 – Consumption Growth vs. Other Major Economies

<http://truewealthpublishing.asia/wp-content/uploads/2016/08/China-Consumption-Growth-Compared-to-Other-Leading-Economies-e1472179712176.png>

Exhibit 5 – Sales of Consumer Goods (2012-2015)

http://economists-pick-research.hktdc.com/resources/MI_Portal/Article/rp/2016/06/475020/1466580519140_e13FiveYearPlan-ConsumerDemand-c1_475020.jpg

Exhibit 6 – Recent Perception on Enforcement of IPR

http://www.consultancy.uk/illustrations/news/detail/1466688040678_improvement-to-Chinas-IPR-enforcement.jpg

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